



## WHEN COMPLIANCE FAILS

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## TABLE OF CONTENTS

I. INTRODUCTION	87
II. COMPLIANCE AND THE ORDER OF CONTROL IN ORGANIZATIONS	88
III. CONSULTANCY EXPERIENCES IN THE FIELD OF COMPLIANCE	90
A. The functions of Compliance	91
B. Vagueness and Operationalization of Legal Norms	92
C. Role Conflicts and Organization-internal Disregard	93
IV. CONCLUSION	94

## I. INTRODUCTION

Just about three months before the Volkswagen-manipulations of exhaust fumes were revealed and caused the biggest corporate scandal in the history of this carmaker, the group proudly published latest the results of their compliance-related measures. For VW, at that time the world still seemed to be in order. Due to an intensive preventive work, it was said, as a consequence of suspected independent controls, of “intensive investigations” and of checking “basic procedures”, one would conduct “a very effective”, successful and sustainable compliance management. Representatives of VW’s compliance department supported their statements by presenting the following figures: in the year 2014 every third employee (185.000 persons) had participated in compliance training events, the internal audit department had started investigations in 365 cases, 72 employees had lost their jobs because of irregularities, and one had terminated contracts with business partners in 16 cases because they had given cause for suspicion.<sup>1</sup> Furthermore, even the anti-corruption organization Transparency International in their sustainability report at the end of 2014 ranked VW in the leading group of world’s largest transparent companies.<sup>2</sup>

When shortly thereafter the scandal came to light, all these assurances and assessments turned out to be untenable assertions. The whole compliance management suddenly was left foolishly dangling in the winds. And especially after it was revealed that officials of VW already had been informed about possible illegal manipulation in 2011, the case raises the following questions: why did it take so much time unless the fraud came to light? Where have the company’s inspectors been? What went wrong with the communication and cooperation between the internal investigators, the engineers and the management staff? Why could compliance not fulfill its purpose? Because the actual case of VW is not an isolated incident – similar phenomena of failing compliance procedures were already observed in cases like Siemens, Daimler or MAN –, this paper focuses on a general reason for the failure of compliance.

In the following the reason for this will be primarily identified with failing processes of establishing legal norms within an organizational context. Therefore the text highlights the topic of failing compliance from an organizational sociological perspective based on observations made during a training seminar for compliance officers. Organizations, this will be the underlying basic assumption of the following argumentation, normally act as

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<sup>1</sup> Statements by Peter Dörfler, Head of Auditing and Stephan Wolf, Member of the Compliance Council of VW.

<sup>2</sup> Transparency International Deutschland e.V., *Nachhaltigkeitsberichte Deutscher Großunternehmen Wiederholungstudie 2014*, available at [https://www.transparency.de/fileadmin/pdfs/Themen/Wirtschaft/Nachhaltigkeitsberichte\\_Grossunternehmen\\_2014.pdf](https://www.transparency.de/fileadmin/pdfs/Themen/Wirtschaft/Nachhaltigkeitsberichte_Grossunternehmen_2014.pdf) (last visited Jan. 5, 2016).

co-producers in processes of enforcing legal norms.<sup>3</sup>

By using programs, guidelines, instructions and controls, they translate social law into internal, formal rules or “organizational law”. Such organizational activities are legally binding and normally there is nothing new or problematic with them. Implementing legislation, for example in the fields of consumer law, tax law or labor law, has a long history and has long been carried out by routine work. Members of organizations by and large became familiar with these topics and normally employees understand what is expected of them. This looks different in the field of corporate crime law. Here, a routine implementation of legal norms is difficult because business criminal law is a very dynamic and complex law sector, marked by numerous changes on the one hand. On the other hand a translation of legal norms is complicated for organizations here because of internal, structural reasons. This article will examine some of these reasons. The thesis is that in the case of compliance, the coexistence of organizational norms and legal rules (“hard law” and “soft law”) causes tensions and structural conflicts, because it disturbs the inner order, cooperative relationships and the role structure of the organization. Newly established compliance systems tend to undermine the legitimacy of legal norms, because they tend to prevent routine procedures of control, and they tend to fail to provide target groups with definite orientation.

In the following sections such assumptions will be explored empirically. In a first step, general characteristics and consequences of compliance as a new form of control of white-collar crime are sketched from an organizational sociological perspective (II.). Second, expectations and perceptions of compliance officers will be described when it comes to implementing legal norms. These perceptions are reconstructed on the basis of a participant observation made during a training seminar for compliance officers in Germany (III.). The article concludes with a statement that identifies the problems of translating legal norms into organizational structures with the fundamental and structural characteristics of organizations as social forms (IV.).

## II. COMPLIANCE AND THE ORDER OF CONTROL IN ORGANIZATIONS

The ongoing boom of compliance as a subject and a market for corporations worldwide can be explained by a change of the legal situation in the field of economic crime. Reflecting on the development in this field, one can say that there has happened a kind of “outcry” for control as a consequence of the scandals, accounting frauds and

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<sup>3</sup> Lauren Edelman & Marc C. Suchman, *When the Haves hold Court: Speculations on the Organizational Internalization of Law*, Berkeley Law Scholarship Repository (1999), available at <http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1802&context=facpubs> (last visited Oct. 12, 2015); SIM B. SITKIN & ROBERT J. BIES (eds.), *THE LEGALISTIC ORGANIZATION* (1994).

smashups around Enron and WorldCom in the early 2000s. Since then the relevant laws have been continuously tightened. As a consequence of changes in corporate criminal law, corporations are faced with increasing demands to take action themselves. The state and the public expect more “translation work” from business corporations. These are forced to launch new forms of control, and therefore new compliance systems are established in order to strengthen the link between organizational processes and legal norms.<sup>4</sup>

What might this development mean for the internal structure of organizations and their orders of control? What kind of measures seems appropriate and reasonable to put the new legal norms into controlling practice? Controlling structures in organizations, this is an old and proven finding in organization sociology, work best when they are based on routines, clear cut tasks, comprehensible instructions and when they are embedded in satisfactory exchange relations.<sup>5</sup> But in contrast to this, a new feature of the law-compliance-control-constellation is a combination of various distinct requirements, heterogeneous purposes and demands on the firms. Besides an increase of regulative rules, judicial criminal controls and besides increasing liability risks, an increased sensitivity of the public towards economic crime constitutes an additional factor corporations have to take into consideration. Accordingly, organizations are expected to adapt to possible rule-breaking behavior or to violations of norms simultaneously in a preventive, actively controlling and reactively-investigative manner. This bundle of necessities can lead to a mutual reinforcement of each sub-target of compliance, involving a rebuilding of the organizational structure as a whole. By this, the new legal requirements show new characteristics in three dimensions:

- With regard to the factual accuracy of organizational behavior and responsibilities, the new regulatory-legal expectations are causes of disorder. They are less clearly and less uniquely defined as before and they are sometimes topically diffuse. Different areas of organizational work can simultaneously be affected by the tightening of criminal law. Therefore, as a result of numerous new regulations, grey areas between “still allowed” and “forbidden” ways of behavior increase.
- Concerning the social sphere of organizations, new social roles, new contact areas and new potential conflicts between employees can develop. Due to creating new compliance-jobs or departments, new responsibilities emerge in organizations that tend to collide with already existing controlling institutions (for in-

<sup>4</sup> Ralf Kölbel, *Wirtschaftskriminalität und unternehmensinterne Strafrechtsdurchsetzung*, 91 MschrKrim, 22, 22 (2008); Hans Krause Hansen, *Managing corruption risks*, REVIEW OF INTERNATIONAL POLITICAL ECONOMY 251, 253f. (18.2011).

<sup>5</sup> Jeffrey Pfeffer, *The costs of legalization*, in *The Legalistic Organization* (Sim B Sitkim & Robert Bies eds.1994); ARNOLD. S. TANNENBAUM, *CONTROL IN ORGANIZATIONS* 14ff. (1971).

stance the internal audit department). Relationships of trust, loyalties, work-flows and routines can be jeopardized by compliance.

- From a temporal perspective, the new compliance control differs from conventional references to law insofar it is now put on a permanent footing. Now law as an external premise of organizational decision making is not a single, exceptionally activated medium anymore. Rather, it has developed to an ongoing background-theme of work, for example mentioned in regular trainings, in codes of conduct, in risk assessments or in monitoring processes. By compliance, legal considerations in general are more strongly connected to everyday-practices.

To sum it up: the described factors and characteristics of compliance are meant to strengthen the connection between organizational and legal norms. Law shall be more “embedded”<sup>6</sup> in organizational rules of procedures as well as in areas of responsibility. It is supposed to guide activities much stronger. For this purpose, controls become more formalized and differentiated, rules are modified. In general, one could say, for organizations the introduction of compliance takes on the character of a reform. But still today it seems to be generally difficult to implement these rights based compliance-reforms. Research on this topic, among other things, report on credibility problems or on a deficient deterrence of corporate misconduct.<sup>7</sup>

Regarding this, the crucial issue we are confronted with is how this problem presents itself from the point of view of compliance officers. How are problems of the translation/ implementation of legal norms practically articulated? We will discuss these questions on the basis of experiences made during a compliance-training seminar.

### III. CONSULTANCY EXPERIENCES IN THE FIELD OF COMPLIANCE

The observations described in the following result from data recorded during participation in a one-week further education seminar for business professionals and executives. This seminar, conducted in winter 2014, aimed at qualifying the participants as certified so called “compliance officers”. The total number of participants was 19, most of them being in charge of compliance, i. e. they were executives from organizational

<sup>6</sup> ARTHUR L. STINCHCOMBE, WHEN FORMALITY WORKS 6 (2001).

<sup>7</sup> Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 Washington University Law Quarterly 487, 490 f. (2003); Jonas Pape, *Zur Wirksamkeit von Corporate Compliance*, CORPORATE COMPLIANCE ZEITSCHRIFT 233, 236 (6.2009); CHRISTINE PARKER & VIBEKE LEHMANN NIELSEN, EXPLAINING COMPLIANCE (2011); Ralf Kölbel, *Wirksamkeit und Funktionsbedingungen von Compliance aus wirtschaftskriminologischer Sicht*, in Handbuch Criminal Compliance 1443 (Rotsch ed., 2014).

supervisory departments (e. g. internal audit or legal department), most of whom working for bigger, sometimes internationally operating industrial, services or financial enterprises. In the course of the seminar, a total number of six different experts gave lectures of four to eight hours every day, among them experts for commercial criminal law, a public prosecutor, a compliance officer from a DAX-30 enterprise as well as auditors. The lectures were, among others, on legal bases, liability risks, compliance organization, prevention, public prosecutor investigations, compliance in the commercial field, data protection and IT compliance as well as so called reactive compliance (internal investigations). The author made notes during his participation and fixed his observations in writing immediately after the end of the seminar. Furthermore, seminar-related documents were assessed, and there was the possibility to interview selected participants.

#### A. The functions of Compliance

Despite the participants showing a basically reserved attitude towards the topic of the seminar (*"This is just a fashionable issue"*; *"We're breaking a butterfly on a wheel"*)<sup>8</sup>, the predominant opinion among the participants was that the establishment of compliance control in their own companies was necessary. The function of compliance – this became clearly obvious by the questions and discussions – was first of all considered a means to be on the safe side when it comes to external prosecution and to avoiding liabilities and image damages for their own companies. The lecturers and the future compliance officers considered it their predominant task to protect colleagues from prosecution by the state: *"This is what we're all interested in: I must internally protect the staff member"*. The prevention of business delinquency was only of secondary interest. Thus, from the point of view of those concerned – and this is a first astonishing insight – a crucial action-stimulating risk results rather from the activities of state supervision and sanctioning authorities than from the threat of potential business delinquents. The threat was symbolized by the figure of the prosecutor. The prosecutor, about whom jokes were made already on the first day, symbolized the hostile forces and bound the participants together. The threat scenario of a humiliating *"visit"* by the prosecutor together with his marauding customs officers appeared again and again (*"The customs officers are always armed; they even come early in the morning when the children are still sitting at the table"*), anecdotes of this kind were told eight times on the whole. Also the US American Securities and Exchange Commission (SEC) was mentioned: *"I'd rather like to have trouble with the Mafia than with the SEC"*, one compliance officer was heard. *"Take care that you're on the safe side, because in case of doubt you are the scape-goat"*, was a lecturer's advice concerning the topic "cooperation with authorities". The repressive component of legal social control was much more emphasized than preventive or protecting aspects. Expenses resulting from legal prosecution seemed to be much

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<sup>8</sup> In the following, text in italics refers to quotations of seminar- participants.

weightier than possible damage by criminal business activities as such. Compliance functions such as informing staff members of marketing issues were discussed in much more detail than functions such as risk assessment or criminal law prevention.

## B. Vagueness and Operationalization of Legal Norms

According to my observations, one crucial problem from the point of view of those being in charge of compliance was that the norms, regulations and instructions were said to lack “*concrete application examples and practical references*”. “*The dirty work of operationalizing*”, as one interview partner had it, or the “*question of implementation*” were considered a core problem of their tasks. As far as exemplary cases were presented, one took them up thankfully and discussed them. In such cases it was most of all about finding out about legal boundaries and about in which situations a legal norm could in which ways be practically implemented. This *operationalization problem* of legal norms can be exemplarily demonstrated by the example of the criminal law on corruption. The *bête noire* for those present was unclear limit between legal and illegal behavior in this field. Anti-corruption compliance, this is well known, is meanwhile considered an obligatory element of each organizational set of regulations, however due to the “mazy” legal situation it is difficult to implement. This was confirmed during the seminar. All participants estimated the risk of being liable under criminal or civil law to be high, however there was uncertainty when it came to the actual meaning of legal terms and thus also when it came to the actual design of effective compliance tools. For example, there was uncertainty concerning the “*appropriate extent*” of hospitality, the beginning of the “*illegal preference*” of clients, or concerning the question of which people may be invited on which business-relevant occasions. There were different opinions about appropriate ways of control, in particular when it comes to sales staff. There were extensive discussions about the fact that difference between legal cultivation of contacts and criminal corruption is difficult to define, in particular if a company operates within the scopes of different national laws and must take cultural differences concerning the habits of its clients into consideration. Against this background, it was said, the legal norms were damaging to business, in so far as they were said to ruin the trust in clients and business partners. In his branch, one participant stated, it had for decades been an essential element of corporate identity to invite business partners. After all, one had been successful only because one had highly estimated “*interpersonal relations*”, and currently the topic was “*completely exaggerated*”. Staff members moving “*in the minefields between criminality and social adequacy*”, it was said, were increasingly feeling at a loss, and now one even had to “*spy on them*”. The fact that furthermore the appropriate trainings or tests for staff members were often at “*kindergarten level*” (*approving laughter among those present*) confirms the overall impression that in this legal field it is difficult to practice any organization-internal operationalization of legal norms and that these norms meet little acceptance. As it is easy to see, the function of law, i. e. coding social situations in such a way as to make them distinctive, is not fulfilled in this field. The problems looked similar in the fields of antitrust law, money laundering legislation and data protection law. One lecturer got at the heart of the problem connected to the operationalization of



the appropriate legal norms when stating: *“One must work out clear rules and guidelines even if there is no explicit legal regulation.”*

### C. Role Conflicts and Organization-internal Disregard

Beyond the so far sketched legal norms-related problems of operationalization, the participants in the seminar were also clearly under stress from inner-company role requirements as well as from thus connected conflicts and lack of recognition. Apart from tasks such as training, marketing and risk assessment, the compliance officers are most of all burdened by mediating and control tasks. The question of which tasks should be focus of a compliance officer in the ideal case was discussed by several participants. A consequence of the basically both many and unclear responsibilities of the compliance officer is disrespect at the company. For example, one participant told at his company initially he had been treated as an annoying *“miniature pinscher”* by the board (he had to *“beg”* for resources), as a competitor by colleagues from the legal and internal audit departments, and as a *“bloodhound”* by the staff members. He then had to spend much effort on receiving recognition, by *“canvassing from door to door”*. To keep compliance processes out of power struggles and clashes of interests or to prevent competition and rivalry, one lecture recommended: *“Talk to everybody involved, talking is important”*; for: *“to survive in the long run you must not be a lone wolf”*. At the same time, he said, the compliance officer had to be careful to stay independent and not to interfere with the operative business. Thus, one had to be involved without being allowed to participate in decision-making, as was the paradox looking advice. There were several lectures and discussions about this topic, the basic clarification of the compliance officer’s possibilities to influence and competences. According to these contributions, a compliance officer seldom meets acceptance. During a lunch break a staff member of an internationally active industrial company told what the management of his company thinks about compliance: *“They [the management] don’t care about compliance, they say: ‘well, write a ten topics paper’, they stay among themselves, you won’t be allowed there”*. Also other participants in the seminar told about lacking recognition at their companies as well as about the difficulties of wanting to advise and support colleagues on the one hand and, being internal controllers, the obligation to keep distance on the other. *“How do you avoid the impression that you secretly report on colleagues?”* was one question which was left unanswered.

These spotlights on the seminar or on the problems told by the compliance officers illustrate that the role of the compliance officer seems to be characterized by difficult tasks, by conflicts and contradicting demands. On the whole, attending this seminar left the impression that the inner-organization implementation of given norms of criminal law by way of compliance is problematic in several respects: It does not reduce complexity (rather it creates new uncertainties), it does not seem to provide those involved with fixed points of orientation, it does not initiate any standardized procedures, and it does hardly support motivation and identification with formal control structures. However, making law valid within an organization requires support by recognized, transparent,

legitimation-providing rules. It seems as if it is still a long way to go until a system of rules which is secured by established knowledge stocks and serves as a basis of the legitimacy of norms of criminal law becomes institutionalized.

#### IV. CONCLUSION

The starting point for the considerations here was the assumption that usually organizations contribute as co-producers to the making legal norms valid in society, by translating norms into formal organizational structures in the form of “secondary law” or “soft law”. Some problems when it comes to implementing such translation, embedding and control processes of legal norms in the case of compliance in the context of commercial criminal law have been exemplarily sketched on the basis of experiences made at training seminar for compliance officers. This way it has become clear that obviously compliance generates inner-organizational structural conflicts, as it ties organizational norms more closely to legal norms, thus blocking the system’s own mechanisms legal norms are usually based on. Among these mechanisms there belong clearly defined roles and competences, implementable procedures and routines, but also the possibility to make, if necessary, trust-based adjustments of the inflexible framework of rules. Usually, efficient formal structures within an organization provide expectation-supporting certainty but also allow for flexibility; they are “informally embedded”. In the case of compliance-control, both functions of organizational formality seem to fail: The structure does neither work as a stable point of reference one can rely on if necessary and which standardizes room for manoeuvre nor does it serve as a protective wall or ritual facade behind which one can make informal agreements. Non-transparency and flexibility – necessary preconditions for the functioning of organizational practice – are thus lost. The “costs of the statutory regulation of an organization”,<sup>9</sup> the weakening of loyal relationships as well as the prevention of the capability to adjust are increased. If legitimacy is defined as the “generalized readiness to accept as yet undefined decisions within certain tolerance limits”,<sup>10</sup> these costs or transparency expectations coming along with compliance in connection with criminal law make it ever more improbable. As a result of this legitimacy loss on the other hand commercial criminal law fails to act as a kind of social control, for it is hardly able any more to stabilize normative expectations. Thus, the intended privatization of commercial criminal law supports an erosion of norms, after all. This means that commercial criminal law as we know it is hardly able to keep its promise to prevent undesired or socially harmful conduct and to control business.

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<sup>9</sup> Pfeffer 1994, as cited above in footnote 5.

<sup>10</sup> NIKLAS LUHMANN, LEGITIMATION DURCH VERFAHREN 28 (3rd Edition 1983).